



## **S&P's Views on OPEB**

Presentation to the Massachusetts Commission to Study Retiree Healthcare and Other Non-pension Benefits

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**Thursday, May 31, 2012**

# Wide Range of State OPEB Burdens

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- S&P's Report "The OPEB Burden Varies Widely Among U.S. States"
  - September 22, 2011 shows:
    - Unfunded state OPEB obligations totaled \$545 billion at Fiscal 2010 year end
    - Range of liabilities is wide -- \$0 for Oklahoma to \$61.4 billion for California
    - Median liability: \$3.4 billion
    - Average Liability: \$10.9 billion
    - Massachusetts' Liability: \$16.6 billion

# Our View of State OPEB

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- Comparisons between states are challenging because there are broad differences in what is included for each state. There is also significant variation in the actuarial assumptions used to calculate the liability.
- Many states have taken steps to begin to formally address the liability. This would include establishing a trust, implementing benefit changes, or providing resources to begin to fund the liability.

# Cost Management is a Key State OPEB Credit Consideration

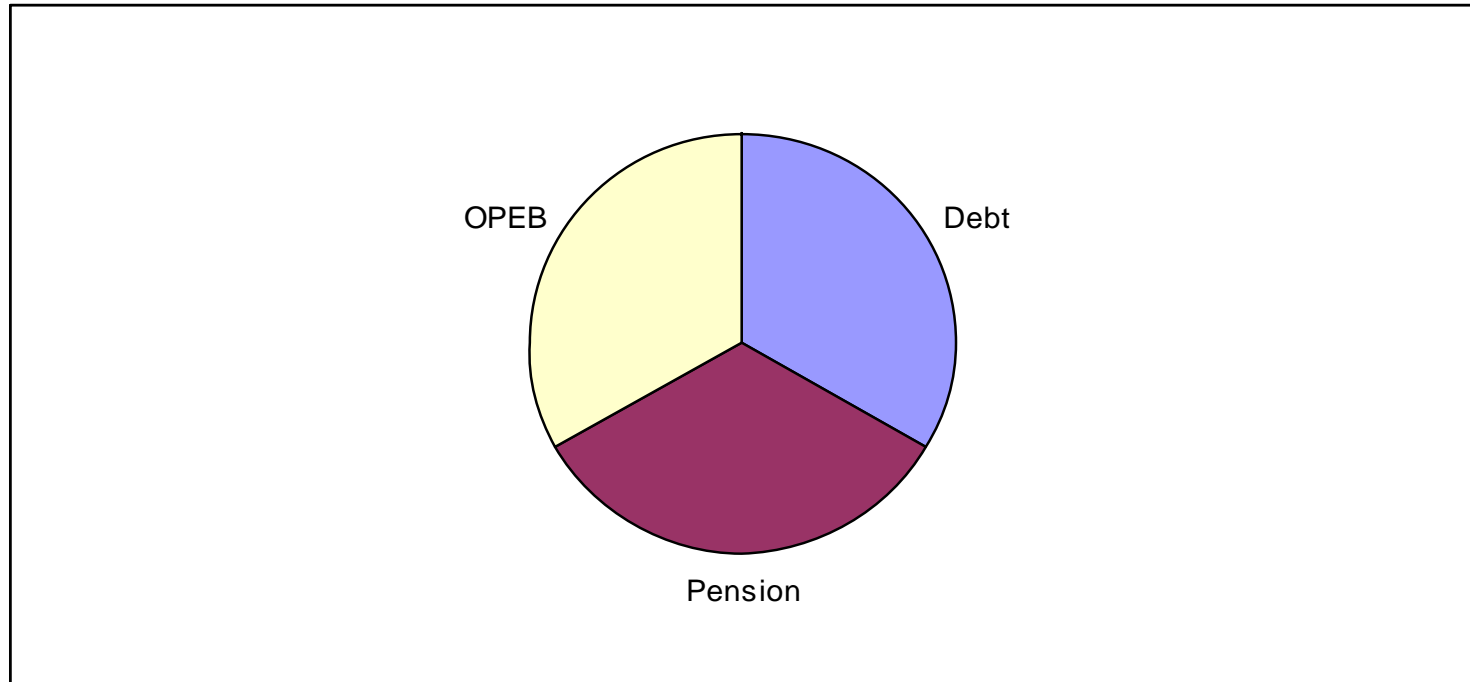
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- We believe that most states will have sufficient time to address these significant liabilities.
- However, the flexibility and willingness to address these liabilities will be key credit considerations.

# State Debt and Liability Criteria

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- Under our state criteria, the key debt and liability metrics (Debt, Pension, and OPEB) are scored individually and weighted equally.



# State OPEB Criteria

- Our state criteria focus on:
  - Size of liability;
  - Level of benefits provided;
  - How fixed cost affects budgets; and
  - Ability and willingness to control OPEB costs.

**Table 29 - As described in paragraph 71**

OPEB Risk Assessment	
Low (1)	Limited benefits provided or benefit consists of allowing some participation in the health plan (cost paid entirely by the retiree, implicit subsidy recorded), high level of discretion to change benefits, pay-go costs are not significantly different from the actuarial required contribution.
Moderate (2)	Moderate/average liability relative to other states, proactive management of the liability in our view, some flexibility to adjust benefit levels, contributions in excess of the annual pay-go amount have been made in order to accumulate assets to address the liability.
Elevated (3)	Above-average liability relative to other states, options to address the liability are being considered but plans are not well-developed in our view, there may be some flexibility to adjust benefits but changes have been limited.
High (4)	High liability relative to other states, high level of benefits that are viewed as inflexible based on statute/constitution/contract terms, a lack of management action to address the liability in our view which will lead to accelerating pay-go contributions.

# OPEB Credit Concerns

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- We believe it may be hard for administrators to focus on a liability that may not be a major problem during their tenure when other needs may be more immediate.
- The OPEB liability may not be immediate, but is also something that cannot be avoided forever.
- To the extent a government contributes only pay-as-you-go OPEB costs, both annual OPEB costs and total unfunded liability will increase each year– this is a concern from a credit perspective.

# Current U.S. Local Government Criteria

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“From a credit standpoint, OPEB liabilities and funding strategies will be evaluated in a similar way to pension obligations. This analysis will include a review of the historical and projected pay-go costs for OPEB, the newly quantified unfunded liabilities and current funded status, and the plan for managing ongoing annual required contributions. Also, the impact of projected annual OPEB costs on the current and future budgets will be assessed. This review would also include the legal and practical flexibility a specific government has in managing these obligations from both the asset and liability perspectives.”



# Proposed U.S. Local Government Criteria

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- Proposed local government criteria was released on March 6, 2012 in a Request for Comments.
- The proposed criteria would assess and score the areas of institutional framework, economy, management, budgetary flexibility, budgetary performance, liquidity, and debt and contingent liabilities (including OPEB).
- Under the proposal, the impact of pension and other postemployment benefit (OPEB) obligations depends on the degree to which such costs will likely escalate and whether the government has plans to address them.
- Relative to debt, governments have a higher level of flexibility to address these costs. Many governments have the flexibility to alter benefit levels, and most governments can pay less than the actuarial required contribution and remain able to meet actual obligations in the current and following year.
- On the other hand, such delays accelerate the growth rate of future payments. When the potential for such acceleration exists and the increased payments increase budget stress, the final debt and contingent liabilities score is proposed to be lowered, even if a specific and credible plan to address this burden exists. The score would be lowered further if there is no plan.

# Massachusetts – Rating Report

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- AA+/stable - Upgraded in September 2011.
- Massachusetts has a \$16.6 billion unfunded actuarial OPEB liability, which we consider sizeable. The commonwealth has established a trust fund to begin to accumulate assets toward the liability, which had a balance of \$350 million as of June 30, 2011. The 2012 enacted budget provides that 10% of all tobacco settlement payments to the state be dedicated to the trust fund, with an additional 10% added each year until the deposit reaches 100% of the payments. This is expected to provide a recurring source of revenue to the trust.

# Massachusetts – from the 2011 State OPEB Report

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“While the liability is significant in our view, we believe that Massachusetts has begun to manage this liability as evidenced by the trust fund and other measures. A special commission was created and released a report in July 2008 that recommended the commonwealth develop a strategy to fund the liability. Supplemental budget legislation was passed in 2009 that increased the health care contributions to 20% from 15% for state employees whose retirement is effective on or after Feb. 1, 2010, which should add additional resources to fund future liabilities. A law passed in 2010 requires that 5% of capital gains revenue over \$1 billion each year would be transferred to the State Retiree Benefits Trust Fund and be used to address the OPEB liability. As part of the fiscal 2012 budget, the Tobacco Master Settlement Agreement funds will be dedicated to the trust fund on a phased-in basis. Starting in fiscal 2013, 10% would be allocated to the fund and an additional 10% would be allocated each year until 2022.”

# S&P Pension and OPEB Articles 2008-2011

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- The OPEB Burden Varies Widely Among U.S. States
- U.S. States' Pension Funded Ratios Drift Downward
- U.S. State Ratings Methodology
- S&P's Views Of GASB's Proposed Changes In Government Pension Accounting
- U.S. States And Municipalities Face Crises More Of Policy Than Debt
- Pension Funding And Policy Challenges Loom For U.S. States
- Request for Comment: Methodology For U.S. State Ratings
- The Recession's Impact On U.S. State And Local Government Credit Risk
- U.S. States' OPEB Liabilities And Funding Strategies Vary Widely
- Market Declines Will Shake Up U.S. State Pension Funding Stability
- How "Smoothing" Can Ease The Pain Of Pension Fund Losses For State And Local Governments
- Market Volatility Could Shake Up State Pension Funding Stability
- OPEB Liabilities Pose Some Risk For State And Local Governments
- Time May Be Ripe For A POB Revival

# S&P Pension and OPEB Articles 2005-2007

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- OPEB Obligation Bond Funding Strategies Offer Risks and Rewards
- U.S. States Are Quantifying OPEB Liabilities And Developing Funding Strategies As The GASB Deadline Nears
- California's OPEB Liabilities Are Prompting A Review Of Future Funding Decisions
- New Texas Law Affecting State And Local OPEB Reporting Will Have No Immediate Rating Impact
- Improved U.S. State Pension Funding Levels Could Be On The Horizon
- Credit FAQ: OPEB Liabilities Pose Minimal Near-Term Rating Risk For Public Finance Credits
- An Aging Population Challenges U.S. State Budgets And Renews Interest In Health Care Reform
- How Big U.S. Cities Are Faring With The Pension Fund Meltdown
- Accounting for OPEB Liabilities: Can State & Local Governments Cope?
- Funding OPEB Liabilities: What It Means For Minnesota's Local Governments
- Funding OPEB Liabilities: Assessing The Options
- Public Employers Are Exploring A Switch To Defined Contribution Pension Plans
- Are OPEB Obligation Bonds A Viable Option To Fund Liabilities?

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